

**BEFORE THE
ILLINOIS COMMERCE COMMISSION**

Illinois Bell Telephone Company)	
)	
Filing to increase Unbundled Loop and)	Docket No. 02-0864
Nonrecurring Rates (Tariffs filed December)	
24, 2002))	

REBUTTAL TESTIMONY OF

**MICHAEL STARKEY
WARREN FISCHER, C.P.A.**

On behalf of

AT&T Communications of Illinois, Inc.
WorldCom, Inc.
McLeodUSA Telecommunications Services, Inc.
Covad Communications Company
TDS Metrocom, LLC
RCN Telecom Services of Illinois, LLC.
Globalcom, Inc.
Z-Tel Communications, Inc.
XO Illinois, Inc.
Forte Communications, Inc.
CIMCO Communications, Inc.

January 20, 2004

AT&T/JOINT CLEC EXHIBIT 1.1

Rebuttal Testimony of
Michael Starkey
Warren Fischer
ICC Docket No. 02-0864

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1 **I. INTRODUCTION**

2
3 **IA. INTRODUCTION OF WITNESSES**

4 **Q. MR. STARKEY, PLEASE STATE YOUR FULL NAME AND BUSINESS**
5 **ADDRESS FOR THE RECORD.**

6 A. My name is Michael Starkey. My business address is QSI Consulting, Inc., 703
7 Cardinal Street, Jefferson City, Missouri 65101-3748.

8
9 **Q. MR. FISCHER, PLEASE STATE YOUR FULL NAME AND BUSINESS**
10 **ADDRESS FOR THE RECORD.**

11 A. My name is Warren R. Fischer. My business address is 2500 Cherry Creek Drive
12 South, Suite 319, Denver, Colorado 80209.

13
14 **IB. PURPOSE OF TESTIMONY AND RECOMMENDATIONS**

15 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS DOCKET?**

16 A. Yes, we circulated direct testimony on May 6, 2003 regarding SBC's proposals for
17 Shared and Common costs, Annual Cost Factors ("ACFs"), investment factors,
18 Support Asset Factors ("SAFs"), inflation and productivity factors and fill factors.

19
20 **Q. ON WHOSE BEHALF WAS THIS REBUTTAL TESTIMONY PREPARED?**

1 A. This testimony was prepared on behalf of the following clients: AT&T Communications
2 of Illinois, Inc., WorldCom, Inc. (“MCI”), McLeodUSA Telecommunications Services,
3 Inc., Covad Communications Company, TDS Metrocom, LLC, RCN Telecom
4 Services of Illinois, LLC, Globalcom, Inc., Z-Tel Communications, Inc., XO Illinois,
5 Inc., Forte Communications, Inc., and CIMCO Communications, Inc.

6
7 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

8 A. The purpose of our rebuttal testimony is to address issues raised by Illinois Commerce
9 Commission (“ICC”) Staff witness Mark Hanson in his critique of SBC’s non-recurring
10 costs (“NRCs”). Specifically, we address Mr. Hanson’s direct testimony regarding
11 SBC’s decision to include support asset costs in its NRC studies via its labor rates and
12 to assign the mainframe portion of general purpose computing costs as direct costs in its
13 cost studies. While we did not, in our direct testimony, propose that SBC’s method of
14 recovering support asset costs be modified, based on our review of Mr. Hanson’s
15 testimony, we agree with him that these costs are not direct costs and that they should
16 not be recovered as direct costs.

17
18
19 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS.**

20 A. We concur with Mr. Hanson’s recommendation that SBC remove support asset costs
21 from its proposed labor rates. We also concur with Mr. Hanson’s recommendation

1 that SBC remove computer processing costs from its nonrecurring cost studies. Based
2 on our review of Mr. Hanson's testimony as well as our subsequent (to May 6, 2003)
3 review of similar SBC cost studies filed in Indiana Cause No. 42393 and Michigan
4 Case No. U-13531, we agree with Mr. Hanson that SBC has misclassified its support
5 asset costs and its computer processing costs as direct costs. Consequently, we
6 recommend that the Commission require SBC to remove its support asset and
7 computer processing costs from labor rates and NRC studies.

8
9 However, we diverge slightly from Mr. Hanson's recommended method of recovering
10 support asset costs. On page 21 of his direct testimony, Mr. Hanson suggests that
11 support asset costs be recovered through either recurring charges or as part of the
12 shared and common cost markup. We recommend that all support asset costs be
13 classified and recovered as common costs and, as such, be included in the common
14 cost allocator rather than through recurring rates.

15
16 **II. SUPPORT ASSET COSTS**

17 **Q. WHAT ARE SUPPORT ASSET COSTS?**

18 A. SBC witness David Barch describes support asset costs as follows at page 44 of his

19 Direct Testimony:

20 *Support asset expense* Support assets consist of land, buildings,
21 motor vehicles, non-mainframe general purpose computers and

1 other plant used by SBC Illinois personnel in day-to-day
2 operations, which are not in the central office, information
3 origination and termination, or cable and wire facility plant
4 accounts. Support asset expenses are indirect costs of products
5 and are captured in cost studies via the maintenance factor and
6 labor rates. Support asset expenses include the capital costs of
7 the support assets and the operating expenses (including
8 maintenance) attributable to them.
9
10

11 **Q. MR. BARCH CONTENDS THAT SBC'S SUPPORT ASSET COSTS ARE**
12 **MOST APPROPRIATELY RECOVERED IN SBC'S ANNUAL COST**
13 **FACTORS VIA SBC'S MAINTENANCE FACTOR AND ITS LABOR**
14 **RATES. IS THIS THE MOST ECONOMICALLY RATIONAL WAY TO**
15 **RECOVER THESE EXPENSES?**

16 **A.** No, it is not. We concur with Mr. Hanson's conclusion on page 17 of his direct
17 testimony that SBC's recovery of its support asset expenses should not be included in
18 the labor rates used to calculate non-recurring costs or in the maintenance factor portion
19 the of ACFs used to calculate SBC's recurring rates.
20

21 **IIA. RECOMMENDED RECOVERY OF SUPPORT ASSET COSTS**

22 **Q. HOW SHOULD SBC RECOVER ITS SUPPORT ASSET EXPENSES?**

23 **A.** After further review of SBC Illinois's support asset cost study as well as our subsequent
24 (to May 6, 2003) in-depth review and discovery of the comparable cost studies SBC
25 filed in Indiana Cause No. 42393 and Michigan Case No. U-13531 (which did not

1 become available to us until after our direct testimony in this case was issued), it is clear
2 that SBC's support asset costs are really general assets/expenses used in providing the
3 entirety of SBC's products and services. These costs are incapable of being reasonably
4 allocated to any particular service or product. Indeed, in its model, SBC was obviously
5 unable to directly allocate these costs to any particular group of products, *i.e.*,
6 recurring/non-recurring, wholesale/retail or regulated/non-regulated. Specifically, SBC
7 allocates a portion of its support asset expenses to monthly recurring rates via ACFs,
8 non-recurring rates via labor rates, and to all UNEs via a small allocation to common
9 costs. SBC appears to have arbitrarily allocated portions of support asset costs based
10 largely upon its own unilateral discretion rather than according to cost-causation
11 principles. Even so, SBC was not able to allocate its support asset expenses logically
12 to any group of products/services smaller than the total output of the firm. These
13 expenses are generally incurred in the normal course of SBC's business and are not
14 directly related to the production of, or consumption of, any particular product or group
15 of products. As such, SBC's support asset expenses fall squarely within the definition
16 of common costs.

17
18 **Q. ARE YOU RECOMMENDING THAT SBC'S SUPPORT ASSET COSTS**
19 **SHOULD BE RECOVERED AS COMMON COSTS?**

1 A. Yes, we are. The Commission should require SBC to remove all support asset
2 expenses from all cost studies except for its common cost study, and should require that
3 SBC recover the entirety of its support asset expenses as common costs.

4
5 **Q. HOW DOES SBC ILLINOIS CURRENTLY RECOVER ITS SUPPORT**
6 **ASSET COSTS?**

7 A. The former Ameritech Illinois (now SBC Illinois) has historically recovered support
8 asset costs through its shared & common cost factor – the same method of recovery we
9 propose here. Mr. Barch acknowledges this fact on page 52 of his direct testimony.
10 The effect of SBC’s radical change in cost methodology has caused a significant
11 increase to the labor rates SBC uses in its non-recurring cost studies. While SBC
12 allocates a small portion of support asset costs to the recurring maintenance costs
13 included in its ACFs and to common costs, the biggest cost impact is on the labor rates
14 SBC proposes in this proceeding.

15
16 **Q. FROM WHICH STUDIES MUST SUPPORT ASSET EXPENSES BE**
17 **REMOVED?**

18 A. SBC should be required to remove support asset costs from its ACFs (used as inputs
19 to all recurring cost studies), its Service Order Computer Processing study (mainframe
20 computer investment) and its loaded labor rates (used as a primary input into all non-
21 recurring cost studies). To ensure that all of its General Purpose Computer costs are

1 recovered, SBC should add its mainframe and midrange computer investment and
2 expense to its common costs.¹

3
4 **Q. HOW SHOULD SBC'S SUPPORT ASSET COSTS BE ADDED TO THE**
5 **COMMON COST MODEL FOR RECOVERY VIA THE COMMON COST**
6 **ALLOCATOR?**

7 A. Adding SBC's support asset costs to the common cost model first requires that SBC
8 adjust its SAF model (*Ameritech Support Assets 2001.xls*) to state its support asset
9 costs on the basis of SBC Illinois-specific data rather than SBC Midwest regional data,
10 upon which SBC's submitted SAF study is based. This is necessary because SBC's
11 common cost factor is based on Illinois costs while its SAF study is based on Midwest
12 regional cost data. The specific adjustments that are required to make SBC's SAF
13 study Illinois-specific are discussed in greater detail below in Section IIB. Making these
14 adjustments will increase the common cost numerator by an amount equal to the amount
15 of SBC's support asset costs that had been allocated by SBC as either nonrecurring
16 costs or direct costs.²

¹ We are not, at this time, recalculating rates based on our recommendation. In fact, it is our hope that SBC, in its rebuttal testimony, will voluntarily agree to make this change based on Staff's and our recommendations. Rather, we describe the steps necessary to make this adjustment based on our experience in the recent Indiana TELRIC case and the pending Michigan TELRIC case, where we made this same recommendation. If SBC does not accept Staff's recommendation and our recommendation, then we will present revised calculations of SBC's proposed rates as well as applicable revisions to our own calculations to reflect this approach in our rebuttal testimony to SBC.

² The increase in common costs is the difference between the amount of support asset costs SBC currently allocates to its Shared and Common cost study and the entire amount of SBC Illinois's support asset costs. This adjustment affects both the common cost numerator and the direct cost denominator since any

**IIB. CALCULATING ILLINOIS –ONLY SUPPORT ASSET COSTS AND
TRANSFERRING THEM TO COMMON COSTS**

Q. WHY WOULD YOU CALCULATE ILLINOIS-ONLY SUPPORT ASSET COSTS?

A. We recommend determining the portion of support asset costs attributable to Illinois because SBC's support assets study contains support asset costs for all five Ameritech states. The common cost study contains only costs attributable to Illinois. Therefore, in order to reclassify support asset costs on a dollar basis (rather than a factor basis) consistent with the other common costs, we recommend calculating those support asset costs specifically attributable to Illinois.

Q. WHAT VERSION OF SBC'S SUPPORT ASSET FACTORS STUDY SHOULD THE ICC USE TO DETERMINE ILLINOIS-SPECIFIC SUPPORT ASSET COSTS?

A. The starting point for determining the Illinois portion of support assets should be the modified version of SBC's proposed SAF study that we included as Attachment MS/WF-13 to our direct testimony. If the Commission were to require the use of the study originally filed by SBC to make this adjustment, it would need to require bottoms-

support asset costs that were included by SBC in its common cost denominator as direct costs will be removed and included in the common cost numerator as common costs.

up changes in virtually all of the supporting files. There are 12 supporting files that produce amounts included in the support asset factors study, all of which would need to be modified. These files are summarized below:

Ameritech Support Assets Factors 2001

File: Ameritech Support Assets 2001.xls

Ameritech 2001 Investment Data

File: SA Ratio Investment 2001.xls

Ameritech 2001 Expense Data

File: SA Ratio Expense 2001.xls

Ameritech 2001 CC/BC Ratios

File: AIT_2000_CCBC_vm8860_091901.xls

Ameritech 2001 Capital Cost

File: AIT_CAPCS_2000_summary.xls

File: CAPCS_AIT_2001_SA_Run_121101_ac7256.xls

Ameritech 2001 Salaries and Wages Data

File: 6622 SALARY TOTALS 2000.xls

File: AIT 62XX-64XX Salary Totals 2001.xls

File: AIT 6530.6612 Salary Totals 2001.xls

File: AIT 6621 Salary totals 2001.xls

File: AIT 6623 Salary Totals 2001.xls

File: AIT 67XX Salary Totals 2001.xls

We have already performed this analysis, however; therefore, we recommend that the Commission order SBC to use as its starting point for this adjustment the modified SAF study included as Attachment MS/WF-13 to our direct testimony for three important reasons:

1. We have already consolidated all of the necessary supporting files as worksheets in a single Microsoft® Excel file. The only file that is excluded is SBC's regional CAPCS model, which is used to produce regional capital cost factors. However, this file is linked to our modified support asset factors study via formula reference.

2. Attachment MS/WF-13 already corrects the data entry errors in SBC's inputs in those instances in which SBC's inputs differed from those included in its general ledger. We discussed these necessary adjustments to SBC's data entry errors in our direct testimony.
3. Attachment MS/WF-13 reflects our recommended adjustments for capital cost factors and regulated data if the ICC adopts our recommendations.

Q. HOW SHOULD THE ILLINOIS PORTION OF SUPPORT ASSET COSTS BE DETERMINED?

A. The following specific adjustments in our Attachment MS/WF-13 will allow the Commission to determine the amount of Illinois support asset costs to transfer into the common cost factor calculation:

1. Replace the general ledger data for all five SBC Midwest states with Illinois general ledger data only. This adjustment should be made in the following worksheets using 1999 and 2000 general ledger amounts provided by SBC: *SA INV* and *SA EXP 2000*. The Illinois-specific general ledger amounts must be keyed in by hand from two files provided by SBC in its ACF supporting documentation: *GL Illinois 1999.pdf* and *GL Illinois 2000.pdf*.
2. SBC should use the Illinois-only salary and wage amounts from the following worksheets:
 - *62xx-64xx Salary Totals*
 - *AIT 6530.6612 Salaries*
 - *6621 Salary Totals*
 - *6622 Salary Totals*
 - *6623 Salary Totals*
 - *67xx Salary Totals*
3. The regional percentage allocation of total building investment and expense among the Administrative, Network Support and Network categories must be changed to match those used by SBC for its Illinois operations in the ACF model. This change must be made in the following worksheets: *optg expense*

(Account 6121.1 – L & B House Service expense) and *capital costs*
(Accounts 2111 - Land and 2121 – Building investment).

4. SBC must include the entire Illinois investment and expense amounts for General Purpose Computers, and should not exclude mainframe computer costs. Mainframe computer costs can therefore appropriately be removed from the nonrecurring Service Order Computer Processing study. This change must be made in the following worksheets: *optg expense* (Account 6124) and *capital costs* (Account 2124).
5. The regional CC/BC ratios used by SBC must be replaced with Illinois CC/BC ratios. SBC's regional CC/BC ratios come from worksheet *AIT Composite* in our modified study. The Illinois CC/BC ratios are found on worksheet *Illinois*.
6. If the ICC adopts the Joint CLECs' recommended capital cost factors, then the only change required in Attachment MS/WF-13 is to replace the average effective tax rate for the Midwest region with the effective tax rate for Illinois. If the Commission adopts some other amounts, the capital cost factors used in the study would have to be revised using SBC's CAPCS model.

The Illinois support asset costs to be transferred into common costs should then be summed as follows from worksheet SA-3:

SUPPORT ASSET COST	TAB SA-3 LOCATION	ILLINOIS AMOUNT
Operating Expenses	Column C, Line 10	\$X
Capital Related Costs	Column C, Line 20	\$Y
Illinois Support Asset Costs	Column C, Line 21	\$X + \$Y

Q. WHERE SHOULD THE ILLINOIS SUPPORT ASSET COSTS BE TRANSFERRED?

A. The entire amount of the Illinois support asset costs should be transferred to SBC's common cost factor calculation by importing support asset costs by individual

1 investment and expense account from the modified support asset factors study into the
2 inputs worksheet in SBC's Shared & Common cost model. This worksheet is called
3 *Tab 2 - Inputs*. These amounts should be recorded on Lines 196 – 209 of the study,
4 which then flow through to SBC's common cost algorithm.

5
6 **Q. HOW DOES THIS SUPPORT ASSET COST ADJUSTMENT AFFECT SBC'S**
7 **SHARED AND COMMON COST STUDY?**

8 A. This support asset cost adjustment will increase the common cost amounts on *Tab 3 –*
9 *Calculations* that comprise the Support Asset Cost line item within SBC's common
10 cost numerator (Line 11 on *Tab 1 – Results*). SBC's common cost algorithm will
11 make a corresponding adjustment to remove this increase in common costs from the
12 pool of direct costs that comprise SBC's denominator in the common cost factor
13 calculation. SBC's algorithm on *Tab 3 – Calculations* starts with a pool of direct and
14 common costs (column L) derived from its series of adjustments to book investment
15 and expense. Common costs are determined through various calculations on *Tab 2 –*
16 *Inputs* and then brought into *Tab 3 – Calculations* in column N. The difference
17 between the two columns is the direct costs in column M.

18
19 **Q. IS THERE AN ADDITIONAL ADJUSTMENT REQUIRED TO ENSURE**
20 **THAT ALL SUPPORT ASSET COSTS ARE TRANSFERRED TO**

1 **COMMON COSTS FOR RECOVERY VIA THE COMMON COST**
2 **FACTOR?**

3 A. Yes. It is necessary to add mainframe computer investment and expenses back into the
4 Shared and Common cost study. SBC originally excluded these costs from its shared
5 and common cost study and assigned these costs to its nonrecurring Service Order
6 Computer Processing cost study. Specifically, SBC had excluded mainframe computer
7 investment and expenses from Accounts 2124 (General Purpose Computer investment)
8 and 6124 (General Purpose Computer expense). This SBC exclusion must be reversed
9 to ensure that the full amount of General Purpose Computer costs is recovered through
10 the common cost factor. These amounts are contained on *Tab 2 – Inputs*, cells E147-
11 E148. SBC's adjustment can be reversed by changing these values to zero.

12
13 **Q. HOW CAN ONE VERIFY THE ACCURACY OF THE TRANSFER OF**
14 **ILLINOIS SUPPORT ASSET COSTS TO COMMON COSTS?**

15 A. One can verify that all Illinois support asset costs are included in the common cost
16 factor calculation by looking at Line 11 of *Tab 1 – Results* in the modified Shared and
17 Common cost study. This line represents the Support Asset Cost additive that SBC
18 includes in its common cost factor calculation. The series of adjustments that we
19 outlined above change this value from the amount of support asset costs SBC originally
20 allocated to common costs to the entire amount that we recommend be appropriately
21 allocated and recovered as common costs. This amount should equal the total amount

1 of Illinois support asset costs included in the SAF study, with the potential exception of
2 some small rounding differences.

3

4 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

5 **A.** Yes, it does.